

Message Text

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INFO USCINCEUR

S E C R E T ADDIS ABABA 6466

E.O. 11652: GDS

TAGS: PFOR, MASS, ET, US

SUBJECT: DISCUSSIONS WITH IEG ON MILITARY EQUIPMENT

REF: STATE 116093

1. SUMMARY. WE BELIEVE THAT IEG CASH PURCHASE OF MILITARY EQUIPMENT INCREMENT TO PACKAGE HITHERTO CONTEMPLATED WOULD BE MANAGEABLE FROM STANDPOINT OF ITS FOREIGN RESERVE HOLDINGS. US AGREEMENT TO STRETCH OUT PAYMENTS ON BASIS DELAYED DELIVERY SCHEDULE WOULD SIGNIFICANTLY MITIGATE ADVERSE IMPACT OF COOPERATION ON DEVELOPMENT EFFORT. WE DO NOT BELIEVE A MODERATE INCREMENT WOULD VASTLY INCREASE MILITARY VALUE OF TOTAL EQUIPMENT PACKAGE. EMBASSY RECOMMENDS THAT RESPONSE TO IEG REGARDING INCREMENT PROPOSAL STRESS USG CONCERN WITH IMPLICATIONS OF INCREMENT FOR SEVERAL REASONS, BUT NEVERTHELESS INDICATE THAT USG WILL PERMIT AN INCREMENTAL CASH PURCHASE OF \$10.5 MILLION IF IEG WISHES TAKE SUCH ACTION DESPITE SERIOUS CONCERNS EXPRESSED BY USG.

2. PARA 1 REFTEL REQUESTS ECONOMIC IMPACT ASSESSMENT OF PLANNED US\$45 MILLION CASH AND CREDIT SALES TO IEG IN FY-74 AND 75 AS WELL AS IMPACT OF POSSIBLE ADDITIONAL CASH PURCHASES UP TO US\$30 MILLION.

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3. IT SEEMS PROBABLE THAT IEG WILL UNDERTAKE TRANSACTION

AS EXTRA-BUDGETARY OPERATION. CASH PURCHASES OF PROPOSED MAGNITUDE CANNOT BE ACCOMMODATED WITHIN EXISTING BUDGET. MOREOVER, THEY COULD NOT BE EASILY CONCEALED IN ANY BUDGET ADJUSTMENT SUBMITTED TO PARLIAMENT. UNDER THESE CIRCUMSTANCES, IEG WOULD BE REQUIRED TO SUBMIT OPERATION TO PUBLIC PARLIAMENTARY DEBATE, WHICH WE DOUBT, OR HANDLE IT ON EXTRAORDINARY BASIS. IF OPERATION TAKEN TO PARLIAMENT, HOWEVER, WE WOULD EXPECT PARLIAMENTARY APPROVAL. THEREFORE, UNIMPEDED IEG ACCESS TO FOREIGN RESERVE HOLDINGS IS PRESUMABLY ASSURED. ISSUE IS ONE OF ABILITY OF RESERVES TO FUND OPERATION.

4. ON BASIS LATEST PUBLISHED FIGURES FOR END OF APRIL 1974, IEG NET FOREIGN EXCHANGE HOLDINGS CAN BE CONSERVATIVELY ESTIMATED AT US\$221 MILLION. THIS FIGURE INCLUDES IEG'S IMF GOLD TRANCHE OF US\$8.29 MILLION BUT NO ADJUSTMENT IS MADE FOR LIABILITIES OF NATIONAL BANK TALLING US\$2 MILLION AT END OF FEBRUARY 1974 OR NET FOREIGN EXCHANGE POSITION OF COMMERCIAL BANKING SYSTEM, WHICH AT THIS TIME OF YEAR IS USUALLY AT LEAST SLIGHTLY POSITIVE. ESTIMATE REPRESENTS 12 MONTHS IMPORT COVER AT 1973 LEVELS.

5. OBSERVERS GENERALLY AGREE THAT IMPORT DEMAND WILL REMAIN SLUGGISH THROUGH AT LEAST REMAINDER 1974 WITH ADDITIONAL COST CRUDE OIL IMPORTS CALCULATED AT NO MORE THAN US\$40 MILLION. SINCE COFFEE AND PULSE EXPORT PRICES EXPECTED TO REMAIN FAVORABLE THROUGH 1974, BEST PRESENT ESTIMATE OF RESERVE POSITION AT YEAR'S END WOULD BE NO WORSE THAN US\$180 MILLION OR 9.7 MONTHS IMPORT COVER AT 1973 LEVELS. UNDER THESE CIRCUMSTANCES, AN ABRUPT ADDITIONAL US\$55 MILLION REDUCTION IN RESERVES (US\$25 MILLION PLANNED PLUS ADDITIONAL \$30 MILLION POSSIBLE CASH SALES) WOULD REDUCE HOLDINGS TO 6.7 MONTHS IMPORT COVER. THIS IS TOLERABLE FLOOR PERMITTING SIMPLISTIC ASSESSMENT THAT IEG CAN AFFORD POSSIBLE PURCHASE THIS MAGNITUDE ON ONE-TIME CASH BASIS.

6. HOWEVER, SUCH A SHARP RESERVE DRAW DOWN OR INCREASE IN OFFSETTING COMMERCIAL BORROWING BY IEG CENTRALBANK AGAINST RESERVES AS COSMETIC OPERATION WOULD SUBSTANTIALLY WEAKEN
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ETHIOPIA'S PRESENT EXCELLENT CREDITWORTHINESS. OVER PAST 12 MONTHS, EMBASSY HAS WITNESSED STREAM OF REPRESENTATIVES FROM MAJOR US BANKS URGING ETHIOPIAN NATIONAL AND COMMERCIAL BANKS TO BORROW. IT WOULD ALSO REINFORCE IEG PROPENSITIES TO RESTRICT PRIVATE CREDIT EXPANSION AND BUDGETARY SUPPORT OF DEVELOPMENT PROJECTS TO CONTROL IMPORT DEMAND. SUCH RESTRAINT WOULD FURTHER DEPRESS ALREADY SLUGGISH ECONOMY AND AGGRAVATE EXISTING LOCAL COST SUPPORT BOTTLENECK TO

FOREIGN-FUNDED DEVELOPMENT PROJECTS. THUS, ANY PROPOSAL TO SPREAD OUT PRESSURE ON RESERVES WOULD BE HIGHLY DESIRABLE.

7. ON BASIS TERMS OF 5 PERCENT INTEREST WITH TWO YEARS GRACE AND 8 YEARS REPAYMENT FOR US\$20 MILLION CREDIT SALES PACKAGE IN FY-74 AND FY-75 AND PAYMENT OF CASH PURCHASES ON AVERAGE DELAYED DELIVERY BASIS OF THREE EQUAL SEMI-ANNUAL INSTALLMENTS BEGINNING IN LAST HALF OF CY 1974, PROJECTED ARMS PURCHASE DRAIN ON RESERVES THROUGH CY 1974 WOULD BE NO GREATER THAN US\$9 MILLION FOR US\$45 MILLION PACKAGE IN CY 1974 (US\$19 MILLION FOR US\$75 MILLION PACKAGE) REDUCING IMPORT COVER TO 9.2 (8.8) MONTHS; US\$18 MILLION FOR US\$45 MILLION PACKAGE IN 1975 (US\$38 MILLION FOR US\$75 MILLION PACKAGE) REDUCING IMPORT COVER TO 8.3 (6.7) MONTHS AND REMAINING AT ABOUT THIS LEVEL DURING CY 1976. ABOVE FIGURES ASSUME NO SIGNIFICANT INCREASE IN IMPORT DEMAND DURING PERIOD UNDER REVIEW. ALTHOUGH, AS PREVIOUSLY INDICATED, THIS ASSUMPTION IS LIKELY FOR CY 1974 AND REASONABLE FOR CY 1975, IT BECOMES LESS PLAUSIBLE WITH HOPED-FOR STEPPED-UP DEVELOPMENT EFFORT BY CY 1976 AND LATER YEARS. HOWEVER, TO DEGREE THAT IMPROVED INTERNAL STABILITY PERMITS STEPPED-UP DEVELOPMENT EFFORT, WE WOULD HOPE THAT EXPORT EARNINGS MIGHT ALSO INCREASE. PROSPECTS FOR MINERAL EXPORT EARNINGS SHOULD ALSO BE CLARIFIED BY END OF 1976.

8. WE THEREFORE CONCLUDE THAT IEG-DESIRED CASH SALES PACKAGE IS MANAGEABLE AND THAT ANY USG AGREEMENT TO STRETCH OUT PAYMENTS ON BASIS DELAYED DELIVERY SCHEDULE WOULD SIGNIFICANTLY MITIGATE ADVERSE IMPACT OF OPERATION ON DEVELOPMENT EFFORT.

9. DEPARTMENT HAS ALSO ASKED FOR EMBASSY/MAAG VIEWS REGARDING "THE ADVISABILITY OF PURCHASES IN EXCESS OF THE \$45 MILLION SUGGESTED FOR CASH AND CREDIT DURING FY-74 AND FY-75". IN SECRET

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A RELATED REQUEST, DEPARTMENT INDICATED IN PARA 4 OF STATE 113789 THAT IT WOULD BE INTERESTED IN EMBASSY/CHMAAG ASSESSMENT WHETHER PROCUREMENT OF LIMITED NUMBER OF ADDITIONAL ITEMS WOULD SIGNIFICANTLY ENHANCE OVERALL CAPABILITY OF PREVIOUSLY CONTEMPLATED GRANT-CREDIT-CASH SALES PACKAGE.

10. THERE IS NO DOUBT THAT IEG WOULD CONSIDER A \$10.5 MILLION INCREMENT WHICH PERMITTED CASH PURCHASES OF 16 VULCAN 20MM SP (APPROXIMATELY \$6.3 MILLION) AND 16 VULCAN 20 MM TW (APPROXIMATELY \$4.2 MILLION) A SIGNIFICANT ENHANCEMENT OF PACKAGE VALUE. EMBASSY AND CHMAAG DO NOT BELIEVE, HOWEVER, THAT ADDITION OF THIS INCREMENT WOULD DISPROPORTIONATELY ENHANCE MILITARY VALUE OF TOTAL PACKAGE. THIS IS PARTICULARLY TRUE BECAUSE, IN VIEW OF LEAD TIME PROBLEM, COMPONENTS OF PACKAGE WILL ARRIVE AT DIFFERENT TIMES AND, WITH FEW EXCEPTIONS, NOT

IN 1974. IF AN INCREMENT IS PURCHASED, MAAG HAS IN FACT RECOMMENDED THAT IT BE DEVOTED TO M-60 TANKS RATHER THAN VULCANS DESIRED BY IEG.

11. HAVING SAID FOREGOING, THE ISSUE REMAINS OF WHETHER USG SHOULD PERMIT IEG OBTAIN AN INCREMENT BY CASH PURCHASE ABOVE \$25 MILLION LEVEL ALREADY CONTEMPLATED. ADDIS 6028 ADDRESSED THIS ISSUE BUT ACTIONS WHICH IEG HAS NOT TAKEN TO INCREASE OPERATIONS AND MAINTENANCE FUNDING HAVE PARTIALLY PREEMPTED APPROACH WE RECOMMENDED IN THAT MESSAGE. IN OUR OPINION, WASHINGTON SHOULD FIRST CONSIDER WHETHER ADDITIONAL IEG CASH PURCHASES WOULD RISK HAVOC IN CONGRESS WITH US ECONOMIC ASSISTANCE PROGRAM FOR ETHIOPIA. IF IT APPEARS THAT THIS HURDLE CAN BE SURMOUNTED, WE WOULD STILL RECOMMEND THAT RESPONSE TO IEG EMPHASIZE (A) OUR CONCERN REGARDING IMPACT OF ADDITIONAL MILITARY EXPENSES ON IEG RESOURCES AVAILABLE FOR DEVELOPMENT; (B) OUR CONCERN WITH POSSIBLE PROBLEMS IEG MAY HAVE WITH IBRD (PARA 6(C) OF ADDIS 6028); (C) OUR CONCERN THAT IEG MAY HAVE ENORMOUS DIFFICULTY IN FINANCING OPERATION AND MAINTENANCE EXPENSES FOR EQUIPMENT ALREADY ENVISAGED; AND (D) OUR CONCERN THAT SUCH LARGE CASH PURCHASES BY IEG MIGHT STIMULATE ADDITIONAL SOVIET DELIVERIES OF EQUIPMENT TO SOMALIA IF WORD THEREOF REACHES MOGADISCIO.

12. GIVEN IEG'S CONVICTIONS REGARDING SOMALI THREAT AND ITS COMPLETE RELIANCE ON USG FOR MILITARY SUPPORT, EMBASSY CON-
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SIDERS IT WOULD BE POLITICALLY DESIRABLE TO CONCLUDE RESPONSE TO IEG WITH STATEMENT THAT USG WILL PERMIT AN INCREMENTAL CASH PURCHASE OF \$10.5 MILLION IF IEG WISHES TO TAKE SUCH ACTION DESPITE ABOVE-MENTIONED SERIOUS WARNINGS CONVEYED BY USG.

13. RE PARA 2 REFTTEL, ETHIOPIAN GROUP LEAVING FOR WASHINGTON JUNE 6, WHICH INCLUDES VICE-MINISTER OF FINANCE, HAS BEEN ADVISED THAT USG MAY NOT BE READY TO RESUME DISCUSSIONS OF MILITARY ASSISTANCE WITH ETHIOPIAN TEAM UNTIL JUNE 11 94 12.

14. FINAL IEG PROPOSAL FOR WEAPONS ACQUISITION IS CONTAINED IN CHMAAG ADDIS MESSAGE DTG 010600Z JUNE 74 AND PARAS 2(B) AND 2(C) OF CHMAAG ADDIS MESSAGE DTG 041330Z JUNE 74.

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